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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	)	Docket No. 96-128

RECEIVED

MAY 24 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

COMMENTS OF THE INMATE CALLING SERVICE PROVIDERS COALITION

Albert H. Kramer
Robert F. Aldrich
DICKSTEIN SHAPIRO MORIN
& OSHINSKY
2101 L St., N.W.
Washington, D.C. 20037
(202) 785-9700

Attorneys for the Inmate Calling Service Providers Coalition

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COMMENTS
OF THE INMATE CALLING SERVICE PROVIDERS COALITION

The Inmate Calling Service Providers Coalition ("ICSPC," or the "Coalition") submits the following comments on the Commission's *Notice of Proposed Rulemaking* in this proceeding. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Order on Remand & Notice of Proposed Rulemaking, FCC 02-39, released February 21, 2002 ("*NPRM*").

BACKGROUND

The *NPRM* arises from the Coalition's court challenge to the Commission's 1996 *Payphone Orders*[1] as they related to inmate calling services ("ICS"). The Coalition sought appellate review of the Commission's 1996 rulings, on the grounds that they failed to ensure fair compensation of inmate service providers and failed to adopt appropriate competitive safeguards for inmate services, as required by Section 276 of the Act. After the

[1] *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 20541 (1996) ("*First Payphone Order*"), *recon.*, 11 FCC Rcd 21233 (1996) ("*First Payphone Reconsideration Order*").

filing of the Coalition's initial brief, the Commission asked the court to return the proceeding to the Commission so that it could provide further analysis. The court granted the Commission's request for remand on January 30, 1998.

On May 6, 1999, the Commission sought comments to update and refresh the record. "The Common Carrier Bureau Asks Parties to Update and Refresh Record for the Inmate Payphone Service Provider Proceeding," CC Docket No. 96-128, Public Notice, 14 FCC Rcd 7085 (1999)("Public Notice"). On February 21, 2002, the Commission issued the Order on Remand & Notice of Proposed Rulemaking, in which it initiated this phase of the proceeding. Applying a stricter compensation standard than it had applied to public payphone service, the Commission declined to prescribe a compensation rate for inmate services or to change its competitive safeguards for inmate services based on the record compiled to date. However, the Commission issued this *NPRM* in which it invited the submission of additional cost information in support of compensation for local collect calls, and further comment on the inmate service compensation issue and certain other issues related to inmate services.

DISCUSSION

I. THE COMMISSION SHOULD PRESCRIBE THE MINIMUM COMPENSATION THAT ICS PROVIDERS MAY COLLECT FOR INMATE LOCAL COLLECT CALLS.

The Commission has commendably allowed an opportunity for inmate service providers to present additional cost information in support of a further evaluation of inmate service compensation under Section 276(b)(1)(A) of the Communications Act. 47 U.S.C. § 276(b)(1)(A). In the *NPRM*, the Commission noted that it had found a number of problems with the cost data submitted to date to demonstrate the need for prescribed minimum compensation for inmate service providers for inmate local collect calls. The Commission invited the submission of additional cost data:

> We seek additional data, to the extent such data can be developed, that might overcome the problems we identified. In particular, we seek cost and revenue data related to local collect calls made from confinement facilities, separate from data related to other services offered by payphone providers. We also seek support and justification for any costs related to inmate calling services (such as depreciation, overhead, or return on investment) that ICS providers assert differ from the costs incurred with respect to ordinary payphones.

NPRM, ¶74.

The Coalition has submitted additional data, described below, which confirms the need for the Commission to prescribe a minimum compensation rate for local collect calls. Such compensation would enable service providers to recover their costs of serving "marginal" confinement facilities (*i.e.*, facilities where no commissions are paid) in those states where they currently are required to charge rates below such costs. As previously discussed by the Commission, such a rate prescription is necessary to ensure widespread deployment of inmate telephone systems and fair compensation for inmate payphone service. Without rate relief, inmate service to small county jails in many states is in jeopardy, and inmate service providers are able to serve other confinement facilities only by charging increased rates for long distance service.

A. The additional cost information submitted by the Coalition demonstrates that a minimum rate of $2.44 per local call is necessary for ICS providers to recover the costs of a marginal inmate phone location.

In response to the *NPRM*'s invitation, the Coalition requested its consultant, Don Wood, to prepare a study of inmate service providers' costs attributable to local collect calls. This cost study determines the cost of inmate local collect calls with substantially greater precision than the information previously submitted by the Coalition in this proceeding, and addresses the defects perceived by the Commission in the information previously submitted. *NPRM*, ¶¶36-38.[2] In addition, the study rigorously adheres to the cost-based compensation methodology followed by the Commission in the *Third Payphone Order*.[3] A description of the study and its results is attached to these comments. *See* Attachment 1.

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[2] To address the issue of separating revenue and cost for local collect calls from other services (*Id*., ¶37), the Wood study identifies service-specific costs and attributes to local collect calls only the service-specific costs that are specific to local collect calls. Non-service-specific costs are identified and allocated in accordance with the methodology approved in the *Third Payphone Order*.

To address the Commission's other concerns (*NPRM*, ¶38) the Wood study avoids treating commissions as costs, has fully documented its determinations of all costs, and has applied the same 11.25% rate of return used in the *Third Payphone Order*. The Commission also questioned why inmate service costs were different from public payphone costs. *NPRM*, ¶38. While there are differences between the costs developed in this study with the public payphone costs determined by the Commission in the *Third Payphone Order*, such differences are to be expected. As the *NPRM* recognizes, there are numerous respects in which inmate service facilities and operations differ from non-inmate payphone services. *Id*., ¶9. Therefore, while the same methodology has been followed in both cases, the cost inputs are different and therefore the results are different. Indeed, it would be surprising, and perhaps a basis for questioning the study, if the costs of the disparate service operations and equipment configurations involved in inmate and non-inmate service had been found to be the same.

[3] In order to ensure appropriate evaluation of such cost data, the Commission must reassess certain rulings in the *Remand Order*. As explained in the Coalition's petition for reconsideration of the *Remand Order (see* Public Notice, Report No. 2553, released May 15, 2002) the Commission should reconsider and rule that: (1) in the inmate service context, Section 276(b)(1)(A) of the Communications Act, 47 U.S.C. §276(b)(1)(A), inmate service providers must be fairly compensated by end users for the full cost of the service they actually provide (not an artificially segregated portion of the service); and (2) compensation for local collect calls requires adjustment if a state rate ceiling prevents inmate service providers from recovering the direct cost of such calls plus a proportionate allocation of fixed or common costs attributable to such calls pursuant to the cost-based compensation methodology followed in the *Third Payphone Order*. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of*

The Wood study finds that an inmate service provider's cost of providing local collect calling service at a marginal confinement facility – defined, as in the *Third Payphone Order*, as a facility to which no commission is paid – is approximately $2.44 per call.

B. State rate ceilings in numerous states prevent inmate service providers from recovering their cost of serving marginal confinement facilities

In the *NPRM*, the Commission seeks information on which states have the lowest rate ceilings, and what impact those low rate ceilings have on inmate payphone provider compensation. *NPRM*, ¶75. The Coalition previously submitted information identifying, to the best of the Coalition's knowledge, the applicable rate ceilings in each state that applies a rate ceiling to inmate local collect calls. *Id.*, ¶11. *See* Attachment 2. Additional information is attached to these comments as examples of the specific state regulations imposing such rate ceilings. *See* Attachment 3. As noted in the *NPRM*, in some cases, the applicable rate ceiling is specific to inmate calls, and is based on the standard local collect calling rates of the incumbent local exchange carrier ("LEC"), while in others the same rate ceiling applies to all calls. *NPRM*, ¶11. In a number of states, the state-imposed rate ceiling for inmate local collect calls is actually *lower* than the incumbent LEC's regular local collect call rate.[4]

The attached information, compiled by the Coalition, indicates that twenty states impose rate ceilings on inmate local collect calls that are less than the $2.44 per call that the Wood cost study finds to be the cost of providing local collect calling service to a marginal

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1996, Third Report and Order and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd 2545, ¶81 (1999)("*Third Payphone Order*").

[4] For example, the rate ceiling for local inmate service calls in Tennessee ($1.00) is lower than Tennessee's rate ceiling for local collect calls from public payphones ($2.75).

confinement facility. In these states, ICS providers are unable to recover the costs of providing local collect calling service to marginal inmate phone locations. Accordingly, it is necessary for the Commission to intervene to ensure widespread deployment of payphone service to confinement facilities in those states.

C. To enable inmate service providers to recover the cost of serving marginal locations in states where rate ceilings prevent such cost recovery, the Commission should prescribe minimum compensation of $2.44 per call for an inmate local collect call

The Coalition's showing that inmate service providers are unable to recover their cost of providing local collect calling to marginal confinement facilities is stronger than the showing that the Commission found necessary to justify deregulation of local coin calling rates in the *First Payphone Order*. Yet, relief requested with respect to local collect calls is less invasive than the total deregulation of local collect calling ordered in the *First Payphone Order*. In the 1996 *Payphone Order*, the Commission determined that "fair compensation" means the level of compensation set by the market. *First Payphone Order*, ¶50. The Commission also made clear, however, that this is true only where the market is functioning properly: "Where the market does not or cannot function properly . . . the Commission needs to take affirmative steps to ensure fair compensation." *Id.*, ¶49. Specifically, the Commission has said it must address the issue of compensation where a "government-mandated rate . . . may not be high enough to be 'fairly' compensatory." *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Notice of Proposed Rulemaking, 11 FCC Rcd 6716, ¶ 16, n.54 (1996).

As discussed in B. above, local inmate calls are an instance where, in many states, a "government-mandated rate" has kept the market from functioning to ensure fair compensation. In approximately twenty states, the state-imposed local collect call rate ceilings do not permit providers to recover the costs of providing local collect calling service to marginal confinement facilities. As a result, the continuation of service to inmates of local jails is threatened in these states.

The Commission has expressly stated its intent to treat inmate payphones the same as public payphones with respect to Section 276's mandate to ensure fair compensation.[5] In both cases, a "government-mandated rate" was a barrier to fair compensation—for public payphones, the local coin rate and for inmate payphones, the state-imposed rate ceilings on inmate local collect calls. The Commission must ensure fair compensation for inmate local collect calls, as it has for local coin calls.

To ensure fair compensation, the Commission need not deregulate local collect calls, as it has in the local coin calling context. Instead, the Coalition requests the Commission merely to rule that, notwithstanding any contrary state regulation, inmate service providers may charge, for inmate local collect calls of the standard allowed length (10-15 minutes), a rate of $2.44 per call.

II. ICS PROVIDERS ACTIVELY SUPPORT ALTERNATIVES TO COLLECT CALLING WHERE FEASIBLE

The Commission seeks comment on alternatives to collect calling in the inmate environment that might result in lower rates for inmate calls while continuing to satisfy security concerns. *NPRM*, ¶76. Coalition members actively support the use, where

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[5] *Remand Order*, ¶*Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Order on Reconsideration, 11 FCC Rcd 21233, ¶ 72 (1996) ("[i]n the [*Payphone Order*], we elected to treat inmate payphones in the same manner as all other payphones . . . .").

feasible, of debit-based alternatives utilizing dedicated prisoner telecommunications accounts or prison commissary accounts. In small jail facilities, unfortunately, such alternatives are generally not cost-effective. In many large facilities, however, and especially in prisons where the average period of confinement is longer than in jails, such alternatives have been found to be cost effective. For the convenience of the Commission, a copy of the Coalition's previous submission on this subject is attached to these comments. *See* Attachment 4.

III. TO FURTHER ELIMINATE UNNECESSARY COSTS, THE COMMISSION SHOULD ADDRESS THE CODE 50 REJECT PROBLEM

One of the most important steps the Commission could take to reduce costs is to issue a ruling, or if necessary, adopt new regulations, to ensure that LECs who include the ability to receive collect calls in the service they offer their customers enter billing agreements enabling service providers to bill the LEC's customers for such calls.

As described in the Coalition's previous submissions, inmate service providers' inability to bill collect calls to competitive LECs ("CLECs") has contributed greatly to the high cost of providing inmate telephone service, and the problem grows ever larger as CLECs' market penetration increases. Currently, few CLECs will enter billing agreements with the industry clearinghouses that make billing arrangements on behalf of service providers. As a result, inmate service providers have no effective means of billing collect calls to customers served by CLECs. Frequently, the line information data base ("LIDB") does not differentiate whether lines in an ILEC's territory are actually served by the ILEC or by a CLEC or reseller. As a result, the inmate telephone service provider frequently completes the call at its own expense, only to find that there is no way to bill the call.[6]

Even where such a differentiation is made, the LIDB may not identify the CLEC that is the "account owner" for the line, and if identified the CLEC may still refuse to enter billing agreements with inmate service providers. In such cases, the inmate service provider has no choice but to block calls to line numbers identified with that CLEC, depriving customers of service.

To overcome this problem, the Commission should issue a ruling as to reasonable practices, or should amend its rules, as follows:

1. A LEC that chooses not to provide collect calling service (*i.e.*, the ability to receive collect calls) and to enter billing agreements with providers of collect calling service shall so notify its customers prior to accepting a service order from the customer.

2. A LEC shall populate LIDB with appropriate toll restrictions if the LEC has not entered into a billing and collection agreement with a company capable of billing telecommunications services.

3. A LEC shall update account ownership information and appropriate toll restrictions information directly into LIDB or contract with the appropriate ILEC for daily updates.

4. An ILEC shall either provide CLECs with access to LIDB or offer to provide updates to LIDB for CLECs.

5. For each line in its territory that is claimed by a CLEC or purchased for resale, an ILEC shall update LIDB with the account ownership code of the CLEC providing retail service on that line.

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6 This aspect of the problem has improved significantly in the last year as more ILECs are willing to update LIDB with information indicating whether the ILEC actually serves a particular line.

Dated: May 24, 2002

Respectfully submitted,

Albert H. Kramer
Robert F. Aldrich
DICKSTEIN SHAPIRO MORIN
& OSHINSKY LLP
2101 L Street, N.W.
Washington, D.C. 20037-1526
(202)785-9700
Attorneys for the Inmate Calling Service Providers Coalition

ATTACHMENT 1

Inmate Phone
Local Call Cost Study

Inmate Phone
Local Call Cost Study

May 24, 2002

Prepared By:

Don J. Wood
Cynthia M. Wilsky
Gregory H. Kraigher

Wood & Wood Consulting, Inc.
4625 Alexander Drive
Suite 125
Alpharetta, Georgia 30022

A. PURPOSE

The purpose of this study is to provide the cost information necessary for the Commission to develop a fair "per-call" compensation rate for local calls to be applied to phones located at inmate facilities.[1] Each step of the cost development process used in this study utilizes the methodology set forth in the Commission's *Third Report and Order, and Order on Reconsideration of the Second Report and Order* in CC Docket No. 96-128 released February 4, 1999 (hereafter *Third Report and Order*). Both the definition of "fair compensation" and the methodology for quantifying the level of fair compensation for a given call type used in this study come directly from the *Third Report and Order* and has not been altered in any way. The **Description of Methodology** (Tab C) section of this study describes this process in detail and provides citations to the relevant paragraphs of the *Third Report and Order* as appropriate.

It is our intention to make this study as open as possible in order to facilitate review. All of the assumptions and calculations are provided in the **Analysis** (Tab D) section, and an electronic copy of the workpapers is being made available. Supporting Documentation for each of the inputs to the study and all key assumptions is available. A statement of qualifications for the preparers of the study is also attached (Tab E).

[1] As the workpapers in the Analysis section (Tab D) make clear, these costs are sensitive to both the number of lines at a given location and the average number of monthly calls per line. Stated differently, "number of lines per location" and "average number of calls per line, per month" are the primary drivers of the costs for all call types, including local calls.

B. RESULTS

B.1 PER-CALL COSTS OF LOCAL CALLS

The following chart summarizes the average per-call cost for local calls made from inmate phones (marginal locations):[2]

Avg. Fixed Cost per Call	Avg. Incremental Cost per Call	Avg. Per-Call Cost of Local Call
$ 1.91	$ 0.53	$ 2.44

In the *Third Report and Order*, the Commission worked exclusively from national average data when calculating a fair per-call compensation amount. In other words, the information regarding per-location investment, LEC charges, and average number of calls per line was available to the Commission only in the form of a broad average.[3] These averages, of course, represented the weighted average of numerous individual locations, few (if any) of which have characteristics exactly equal to the average. In this study, we have begun the process one step earlier with the location-specific data that underlies the average. By doing so, this study gives the Commission the opportunity to see and review information that was unavailable to it in all previous investigations.

To begin the analysis, we collected the relevant information regarding eighteen locations for which complete cost and usage information was available. Some of these locations are currently "zero commission" locations, while others are locations in which a commission is currently being paid. A per-call cost, based in the individual characteristics of each location, was then calculated. The results of this process are summarized below:

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[2] The method used for calculating these costs is described in detail in Section C. Workpapers are included in Section D.

[3] The categories of costs included, and sources of the input data relied upon, are described in paragraphs 144-191.

Inmate phones - County Jail Facilities
Local Call Cost Study
Results - All locations

Location	Fixed Costs per Line	# of lines	Avg billable calls per line	Fixed Cost per call	Incremental Cost per call	Total cost per call
Location A	$ 433.28	5	390	$ 1.11	$ 0.64	$ 1.75
Location B	$ 429.52	3	41	$ 10.48	$ 0.51	$ 10.99
Location C	$ 610.39	2	232	$ 2.63	$ 0.55	$ 3.19
Location D	$ 748.18	1	104	$ 7.19	$ 0.46	$ 7.65
Location E	$ 328.97	20	225	$ 1.46	$ 0.33	$ 1.79
Location F	$ 441.18	5	420	$ 1.05	$ 0.64	$ 1.69
Location G	$ 482.35	4	347	$ 1.39	$ 0.53	$ 1.92
Location H	$ 506.39	3	459	$ 1.10	$ 0.56	$ 1.66
Location I	$ 412.79	4	77	$ 5.36	$ 0.65	$ 6.01
Location J	$ 560.61	2	106	$ 5.29	$ 0.64	$ 5.93
Location K	$ 538.19	2	232	$ 2.32	$ 0.53	$ 2.85
Location L	$ 848.79	1	229	$ 3.71	$ 0.50	$ 4.21
Location M	$ 401.88	12	326	$ 1.23	$ 0.64	$ 1.87
Location N	$ 953.84	1	284	$ 3.36	$ 0.56	$ 3.92
Location O	$ 531.59	3	263	$ 2.02	$ 0.56	$ 2.58
Location P	$ 614.46	2	295	$ 2.08	$ 0.55	$ 2.64
Location Q	$ 626.62	2	348	$ 1.80	$ 0.53	$ 2.33
Location R	$ 437.05	6	97	$ 4.51	$ 0.33	$ 4.83

Weighted Average by # of lines **$ 2.97**

After reviewing these results, we removed two types of locations from the analysis. First, some locations have a small number of lines and a very low average number of calls per line. These locations were excluded from the group of "marginal" locations, consistent with the Commission's conclusion that the methodology used in the *Third Report and Order* "is not designed to make every payphone profitable. Payphones with sufficiently low call volumes or sufficiently high costs will not be profitable, regardless of the compensation amount we establish" ¶79). The following "high cost" locations were removed in order to avoid a potential distortion of the results:

Inmate phones - County Jail Facilities
Local Call Cost Study
Results - High Cost locations

Location	Fixed Costs per Line	# of lines	Avg billable calls per line	Fixed Cost per call	Incremental Cost per call	Total cost per call
Location B	$ 429.52	3	41	$ 10.48	$ 0.51	$ 10.99
Location D	$ 748.18	1	104	$ 7.19	$ 0.46	$ 7.65
Location I	$ 412.79	4	77	$ 5.36	$ 0.65	$ 6.01
Location J	$ 560.61	2	106	$ 5.29	$ 0.64	$ 5.93
Location R	$ 437.05	6	97	$ 4.51	$ 0.33	$ 4.83

Weighted Average by # of lines **$ 6.59**

Second, locations in which commissions are currently being paid were excluded from the marginal location analysis. The remaining locations were used as marginal locations for the purpose of calculating costs. These are locations as follows:

Inmate phones - County Jail Facilities
Local Call Cost Study
Results - Marginal locations

Location	Fixed Costs per Line	# of lines	Avg billable calls per line	Fixed Cost per call	Incremental Cost per call	Total Per-Call Cost of Local Call
Location A	$ 433.28	5	390	$ 1.11	$ 0.51	$ 1.62
Location C	$ 610.39	2	232	$ 2.63	$ 0.55	$ 3.19
Location G	$ 482.35	4	347	$ 1.39	$ 0.53	$ 1.92
Location K	$ 538.19	2	232	$ 2.32	$ 0.53	$ 2.85
Location L	$ 848.79	1	229	$ 3.71	$ 0.50	$ 4.21
Location N	$ 953.84	1	284	$ 3.36	$ 0.56	$ 3.92
Location O	$ 531.59	3	263	$ 2.02	$ 0.56	$ 2.58
Location P	$ 614.46	2	295	$ 2.08	$ 0.55	$ 2.64
Location Q	$ 626.62	2	348	$ 1.80	$ 0.53	$ 2.33

Weighted Average by # of lines **$ 2.44**

B.2 COMMISSIONS TO LOCATION PROVIDERS BASED ON FAIR COMPENSATION FOR LOCAL CALLS

Based on the per-call compensation amount calculated above, we have calculated the amount of the commission that an economically rational IPSP would pay to a location provider, based on the per-call cost for that particular location. The amount of this economically rational commission varies by location as costs vary.

Inmate phones - County Jail Facilities
Local Call Cost Study
Results - Potential Commission locations

Location	Co. / Stat	Fixed Costs per Line	# of lines	Avg billable calls per line	Fixed Cost per call	Incremental Cost per call	Total cost per call	Economically rational commission %[1]
Location E	0	$ 328.97	20	225	$ 1.46	$ 0.33	$ 1.79	27%
Location F	0	$ 441.18	5	420	$ 1.05	$ 0.64	$ 1.69	31%
Location H	0	$ 506.39	3	459	$ 1.10	$ 0.56	$ 1.66	32%
Location M	0	$ 401.88	12	326	$ 1.23	$ 0.64	$ 1.87	23%

Weighted Average by # of lines	**$ 1.79**	**26%**

1 Assuming per call rate set equal to per call cost at marginal location.

C. DESCRIPTION OF METHODOLOGY

This study utilizes the methodology developed by the Commission in the *Third Report and Order.* In that context, the Commission sought to develop a per-call rate that represents fair compensation to Payphone Service providers ("PSPs") for "dial-around" calls. In this study, we are attempting to develop a per-call rate that will represent fair compensation to Inmate Payphone Service providers ("IPSPs") for local calls placed from phones placed in confinement facilities. In order to calculate fair compensation for "dial around" calls and local calls from confinement facilities, it is necessary to address a common set of constraints: a mandatory per-call compensation scheme; a cost structure that is largely insensitive to call volumes, requiring a set of fixed costs to be recovered over an assumed number of calls; and the necessity of identifying those locations that represent a marginal location in terms of call volume (i.e. those locations at which the commission payments are zero). In addition to this common set of constraints, the completion of each task requires that the relevant forward-looking costs of the provider be identified, and verifiable information regarding those costs be collected.

C.1 DEFINITION OF FAIR COMPENSATION

In the *Third Report and Order*, the Commission defined the task before it as one of "ensuring that providers of payphone services receive fair compensation for every call made using their payphones" (¶1). The Commission specifically noted that the language of Section 276(b)(1)(A) of the Act directs the Commission to establish a plan to ensure that PSPs are "fairly compensated" for every completed call, and to provide an opportunity for such fair compensation to be recovered on a per-call basis[4] (¶21).

Because the Act does not provide a definition of the term "fair compensation,"[5] the Commission developed a definition for the purpose of implementing Section 276(b)(1)(A): "we conclude that the default per-call compensation amount we establish should ensure that each call at a marginal payphone location recovers the marginal cost of that call plus a proportionate share of the joint and common costs of providing the payphone" (¶59). This "proportionate share" of joint and

[4] Footnote 34 of the *Third Report and Order* contains the complete citation to the Act: "*See* 47 U.S.C. § 276(b)(1)(A). The exact language directs the Commission 'to establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone, except that emergency calls and telecommunications relay service calls for hearing disabled individuals shall not be subject to such compensation.'"

[5] "Neither the statute nor the legislative history makes clear, however, what Congress meant by the phrase 'fairly compensated'" (¶54).

common costs is to be calculated as follows: "we use the total monthly joint and common costs of the payphone operation and divide these costs by the total monthly number of calls from a marginal payphone location. This results in a per-call share of the joint and common costs" (¶76).[6]

Because the results are intended to provide the basis for a local calling rate that will allow "fair compensation" for these calls, this study develops costs utilizing this methodology.

C.2 MANDATED STRUCTURE FOR COST RECOVERY

While the majority of the relevant costs are traffic-insensitive, the mandated recovery mechanism is traffic-sensitive. The Commission explicitly considered this relationship in the *Third Report and Order*: "[S]ection 276 of the Act mandates a structure for recovering payphone costs, i.e., per-call compensation, that does not reflect the manner in which most costs are incurred by payphone owners. As previously indicated, most common costs of payphones are fixed -- that is, they do not vary with the volume of calls. Section 276, however, requires that PSPs be compensated on a per-call basis" (¶47). The Commission found this to be an imperfect but necessary outcome: "because a per-call compensation mechanism is traffic-sensitive, in order to assure that the fixed costs are covered at a low traffic area, a fixed per-call compensation amount necessarily results in over-recovery of common costs for payphones in high traffic locations" (¶47).

The Commission also concluded that it could not exempt a given call type from the "per-call" requirement: "We find that Congress clearly instructed us in Section 276 to ensure compensation for "each and every" call from a payphone. Congress explicitly exempted only two types of calls: emergency calls (911) and TRS calls. Because Congress did not provide for any other exceptions, we cannot grant an exception for these types of calls" (¶118).

The local calling rate at issue here presents a similar challenge. Because these calls are not emergency 911 calls or TRS calls, the per-call compensation requirement must apply. As was the case with dial-around compensation, the majority of the costs to be recovered through this mechanism do not vary with the

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[6] In the process of reaching this conclusion, the Commission explicitly rejected an approach that failed to recognize the volume-insensitive costs associated with the operation of a payphone: "a purely incremental cost standard for dial-around calls would undercompensate PSPs for dial-around calls, because it would prevent PSPs from recovering a reasonable share of joint and common costs from those calls. Thus, the revenue that would have been received from these calls would be subsidized by revenue from other types of calls, which, in and of itself, contradicts Congress's directive to eliminate subsidies and also distorts competition" (¶81).

number or duration of calls but are instead essentially fixed for a given location.[7] This study follows the methodology previously used by the Commission by identifying these fixed costs and expressing them on a per-call basis, assuming average call volumes at a marginal location.

C.3 TREATMENT OF FIXED COSTS AND PROHIBITION OF SUBSIDIES

With the exception of the coin mechanism, the volume-insensitive costs associated with payphones are also service-insensitive; that is, they are not incurred because the payphone is used to provide a given service or call type. There are two basic alternatives for a per-call compensation mechanism: (1) price a given type of call at or near the level of its marginal cost, or (2) allocate the fixed costs among all services (call types) that utilize this common set of equipment.

In the *Third Report and Order*, the Commission explicitly rejected this first option for two reasons. First, PSPs would not be fairly compensated: "Because payphones have significant fixed costs that must be recovered, the price for each type of payphone call must exceed the marginal cost of the call if the payphone is to earn a normal rate of return. Stated another way, if every call is priced at the marginal cost of that call, the payphone would be unprofitable, because it would fail to recover the predominant fixed costs of providing the payphone" (¶33).[8] Second, an economically undesirable cross-subsidy would be created: "a purely incremental cost standard for dial-around calls would undercompensate PSPs for dial-around calls, because it would prevent PSPs from recovering a *reasonable share* of joint and common costs from those calls. Thus, the revenue that would have been received from these calls would be subsidized by revenue from other types of calls, which, in and of itself, contradicts Congress's directive to eliminate subsidies" (emphasis added, ¶81).

The allocation of fixed costs requires an exercise of judgment. As the Commission noted, "Regulators have long recognized that there is no single correct method for allocating common costs among regulated services. Except for the general rule that regulated services should not cross-subsidize each other, economic theory provides no guidelines as to how common costs should

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[7] As shown in Section D.2, the network access line charges for some inmate phone locations have both a fixed monthly charge and a local usage charge. This local usage charge represents a service-specific, volume-sensitive cost.

[8] Footnote 65 defines normal rate of return: "A payphone earns a normal return when its revenue pays for itself, including the cost of capital used to buy the payphone and all the costs associated with that payphone, e.g., upkeep and the payphone operator's time." This cost study is designed to include each of these categories of cost, but does not attempt to support a compensation mechanism that would result in above-normal rates of return.

be allocated" (¶45).[9] In the Second Report and Order,[10] the Commission reached the conclusion that "fair compensation required that dial- around calls contribute a proportionate share of the common costs of payphone service" (¶42). The Commission affirmed this conclusion in the *Third Report and Order*: "We continue to believe that this is an essential element of our determination of 'fair compensation' in this context. We find that any other approach would unfairly require one segment of payphone users to disproportionately support the availability of payphones to the benefit of another segment of payphone users. Such subsidies distort competition and appear inconsistent with Congress's directive to eliminate other types of subsidies" (¶57).

The structure of this cost study is based on the Commission's conclusion that fair compensation requires that each service or call type contribute a proportionate share of the fixed costs. The total amount (for a given location) of fixed costs is allocated over the entire volume of calls, including local and non-local calls. This mechanism results in a cost for local calls that includes a proportionate share of fixed costs. A rate set at this level will achieve two objectives: (1) it will provide the opportunity for fair compensation for local calls, and (2) end users that make local calls will not be paying a higher amount in order to subsidize other types of calls, and end users making other types of calls will not be paying a higher rate in order to permit the IPSP to recover costs that should be part of the "reasonable share" of fixed costs recovered through the local call rate.

C.4 COST CHARACTERISTICS

In the *Third Report and Order*, the Commission identified two broad categories of costs associated with the operation of payphones. These categories of cost also exist for inmate phones.

First, the Commission recognized that some costs are service-specific; in other words, they can be avoided if the ability of end users to make a given type of call is eliminated. These costs are appropriately included in a cost study of the service that causes them but should not be included as a part of the fixed costs attributable to all services: "We attribute costs that are not joint and common to the type of call associated with that cost. For example, as the number of coin calls from a payphone increases, the coin collection costs also will rise due to the

[9] The Commission provides the economic definition of a cross-subsidy in footnote 81: As long as each type of call recovers its incremental costs, but no more than its stand-alone costs, there is no cross-subsidy." The Commission also elaborated further on its position that end users making a given type of call should not subsidize, or be subsidized by, end users making other types of calls: "Economic theory does suggest, however, that the costs of one service should not be cross-subsidized by another service. That is, consumers making one type of call, such as a local coin call, should not pay a higher amount to subsidize consumers that make other types of calls, such as dial-around or toll-free calls." (¶56).
[10] 13 FCC Rcd 1778.